



THE CITY OF SAN DIEGO

DATE: August 30, 2011

TO: Honorable Members of the Audit Committee

FROM: Eduardo Luna, City Auditor

SUBJECT: **Supplemental Memorandum - Performance Audit of the Capital Improvement Program (CIP)**

On June 29, 2011, the Office of the City Auditor issued a performance audit report on the City's Capital Improvement Program (CIP), which included 24 recommendations to improve planning and oversight so that the City can effectively identify capital infrastructure needs and manage projects within budget and schedule. We presented the CIP report to the Audit Committee on July 11, 2011. As part of its motion to move the report to the full City Council, the Committee requested that we provide additional information on two issues. First, we are providing additional information on recommendation three to establish a Capital Program Office to provide oversight, coordination, and streamline processes. Second, we are providing an update on the City's contracting process, including the reorganization of these functions from Purchasing & Contracting to the Public Works Department, Public Works' current business process reengineering of contracting practices, and our recently initiated performance audit of contracting.

Background

We highlighted in our audit report that the City's CIP process is complex with seven service and nine client departments having various roles and responsibilities for identifying capital needs and implementing projects. Effective oversight and coordination of all departments involved is critical to avoid duplication or gaps in responsibilities of ensuring that projects are efficiently managed within budget and schedule.

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The Value of a Capital Program Office and Capital Plan

No One Office or Leader Oversees or Coordinates the CIP, Leading to Numerous Impediments

Many aspects of the City's CIP process are decentralized, and no one leader or office has the needed overall perspective and authority or is responsible or accountable for overseeing all aspects of the CIP. The City eliminated the position of Deputy Chief Operating Officer for Public Works in 2010, leaving a void of both leadership and reporting structure for the many departments involved in the CIP. As a result of the lack of oversight and coordination, we identified numerous problems, including the following:

- *Issues within departments delay projects.* The contract bid and award process takes about six to nine months to complete, and officials told us this is one of the biggest challenges in implementing projects. In addition, post-construction activities average about 398 days, about three times as long as is spent in the building stage.
- *Lengthy and complex requirements add time to projects, impacting the ability of Engineering & Capital Projects (E&CP) to deliver projects on time and within budget.* For example, the process for obtaining City Council approval for projects averages 90 days each time the project must be docketed and approved. Departments are required to obtain City Council approval for projects at least twice, but numerous factors require additional approval, such as grant requirements and change orders.
- *City is not optimizing or leveraging funding sources.* The City has had challenges complying with the federal requirements for the use of Community Development Block Grants to fund projects. As a result, the City reprogrammed \$11.6 million and cancelled CIP and other projects, including five Americans with Disabilities (ADA) projects, to avoid loss of funds.
- *Issues that cut across departments are not receiving sufficient priority.* The City planned to use proceeds from land sales for ADA projects included in the City's 1997 Transition Plan, but Financial Management did not reconcile the Capital Outlay Fund in time. In addition, when the cash balances were reviewed in June 2011, the fund was overcommitted by about \$17 million. The City is not implementing ADA projects from the Transition Plan in fiscal year 2011, even though about 28 percent of projects included in the plan have not yet been initiated.

City Lacks Integrated, Long-Term Capital Planning

The City lacks a Citywide long-term capital plan and instead uses its annual budget as a five-year rolling CIP. However, the budget does not provide a clear view of the City's planned capital improvements over the next five years because the purpose of a budget is to provide a forecast of expenditures and revenues. Without a true capital plan, the City lacks an effective tool for:

- Identifying Citywide deficiencies or gaps;
- Assessing deferred maintenance and unfunded capital needs;
- Evaluating tradeoffs across asset classes;
- Planning, prioritizing, and arranging financing for major projects; and
- Identifying and accommodating relationships between projects.

Several Cities Use a Capital Program Office to Effectively Manage CIP

We identified several cities and counties that currently use some type of centralized capital program office to manage their CIP, including Austin, TX; Miami, FL: Miami-Dade County, FL; Philadelphia, PA; San Antonio, TX; and San Francisco, CA. The number of staff and structure of these offices vary based upon the needs and responsibilities of the organization. An official told us that the Government Finance Officers Association is considering recommending this type of model in the future due to numerous benefits, including:

- More effective planning and prioritization of deferred maintenance and capital needs and justification for projects;
- Optimization and leveraging of General Obligation Bonds, state and federal grants, and other funding sources;
- Improved accountability for completing projects on time and within budget and intended scope; and
- Increased transparency of the program.

We are providing more specific information for the capital program offices in San Francisco, CA and Austin, TX because these models do not require extensive reorganization.

San Francisco, CA – Capital Planning Program Team

Prior to 2005, San Francisco lacked a long-term capital plan, had limited coordination of departmental needs, and had a highly politicized process for selecting capital projects. Following major mismanagement of a capital project to construct a new hospital and resulting concerns from City leaders and citizens, officials developed an Administrative Regulation requiring that the City develop a ten-year constrained capital expenditure plan.¹ To develop the plan and improve coordination and oversight, the City established a Capital Planning Program team using \$1 million that was previously set aside. The team includes a director and three staff with backgrounds in public planning, budgeting, finance, project management, and IT business; has an annual budget of about \$1 million; and reports directly to the City Administrator. The team provides support to the City's Capital Planning Committee, which includes high-level City officials and department directors—similar to San Diego's CIP Review and Advisory Committee.² The Capital Planning Committee approves the capital plan, makes recommendations to the Board of Supervisors on all capital expenditures, and monitors compliance with the final adopted plan.

The following are key highlights and accomplishments of the Capital Planning Program team and Capital Plan:

- In 2008, after eight years without an approved City bond proposal, the City passed three General Obligation Bonds totaling nearly \$1.5 billion to fund capital infrastructure projects, including the Clean and Safe Neighborhood Parks bond and Earthquake Safety and Emergency Response bond. The City is also planning to include a Safe Streets and Road Repair bond on the November 2011 ballot.³
- As part of its Capital Plan, the City has increased investment in its Pay-as-you-go Program for annual needs to maintain facilities and infrastructure in a state of good repair from about \$12 million to \$50 million annually. This program includes routine maintenance, ADA Transition Plan, street resurfacing, and facility renewal.

¹ City of San Francisco, *Administrative Code 3.20 and 3.21* (San Francisco, CA: Aug. 2005).

² San Diego lacks a long-term capital plan; the CIP Review and Advisory Committee approves the annual CIP budget.

³ General Obligation Bonds are a good method of funding CIP projects because the cost of borrowing is less since it authorizes a tax levy. San Diego has not used these since the 1990s because they must be balloted and require two-thirds voter approval, which can be difficult to achieve.

- The Capital Plan addresses all needed projects, including deferred and emerging needs from the City's more than \$4 billion backlog,⁴ but works within the City's fiscal constraints by prioritizing key projects and deferring implementation for those without realistic or secured funding sources. The Director told us that this helps the City focus on and get traction for addressing deferred maintenance and capital needs.
- The City secured more than \$175 million in American Recovery and Reinvestment Act federal stimulus funds (compared with \$20.2 million in San Diego). San Francisco's Capital Program Director told us that having the Capital Plan made it easier to get stimulus money because they already had approved projects in the queue.
- The Plan recommends almost \$24.8 billion in capital improvements over ten years, which the team estimates will create more than 162,000 local jobs.
- San Francisco's Planning and Urban Research Association awarded the Good Government Award to the Capital Planning Program team for its ability to bring together a large group of City officials and reach consensus on capital investment priorities.

For more information, visit <http://onesanfrancisco.org/projects/>.

Austin, TX – Capital Planning Office

Similar to the City of San Diego, the City of Austin, TX has a decentralized CIP process with much of the capital planning and identification of projects being conducted in multiple large departments. Also like San Diego, Austin had no entity to connect existing department CIP's into a common prioritization and planning framework. Following a high-level review of project delivery and how to better manage its capital program, the City created a Capital Planning Office in September 2010 to address the need for more integrated CIP planning and coordination across the organization. The office was created out of existing resources from several departments, did not require start-up costs, and has an annual budget of about \$750,000. The office is led by the Capital Planning Officer, who reports directly to the City's Chief Financial Officer, and has seven additional staff with various backgrounds—including finance, planning, business process improvement and capital projects/engineering—which are based upon the office's core functions.

⁴ Capital Program Office staff used a Facility Resource Renewal Tool to assess the condition of all City assets and predict the needed projects and level of investment. This has established a consistent

The objectives of the office are to:

- Assess, recommend, and implement improvements in CIP processes and practices.
- Manage the General Obligation Bond process, including making sure the commitment to voters is being met.
- Identify innovative CIP funding strategies and find ways to limit debt financing, including exploring public-private partnership opportunities.
- Develop a strategic, integrated Capital Improvement Plan that supports Citywide goals and priorities; links together key City planning initiatives, City policy and management priorities, and departments' CIP planning priorities; and addresses how to target unfunded needs.
- Advise and update the City Manager about CIP status, issues, and opportunities.
- Report on the CIP to the City Council, public, and other stakeholders.

The Capital Planning Officer told us that by achieving these objectives, the Capital Planning Office has the potential to save the City hundreds of millions of dollars. For more information, visit <http://www.ci.austin.tx.us/cip/cipplan.htm>.

Key Goals and Objectives of a Capital Program Office for the City of San Diego

In our audit report, we recommended that the Administration assess the best organizational structure for establishing a Capital Program Office. While additional resources may initially be required, these can be minimal and will be offset by savings. For example, Austin reorganized existing resources from various departments and San Francisco set aside \$1 million to establish a multi-discipline team with a director and three to seven staff. The key is that this will not create an additional layer of bureaucracy but provide valuable services, leadership, and accountability that the City currently lacks. For example, if the team streamlines processes, increases efficiencies, and optimizes funding sources, it will reduce project cycle time and save the City time and money. The City could save \$22 to \$66 million over 5 years if the office reduces costs by even 1 to 3 percent.

methodology across departments for estimating backlogs and drives annual needs and investments.

Key goals and responsibilities of this office would be to:

- *Streamline and increase efficiencies of complex and lengthy CIP processes, including those reported in our audit and others as identified by the office.*
 - Pinpoint bottlenecks, identify gaps and duplication or redundancy, and determine which steps can be performed simultaneously rather than sequentially.
 - Reduce staff time spent on work, document handling, and delays caused by staff workload and rework.
- By streamlining processes and increasing efficiencies, the City can reduce project cycle time and save money as well as implement efficient, transparent processes.
- *Optimize and leverage funding sources.*
 - Assess opportunities to leverage funding sources across departments, identify projects that can be more cost-effectively implemented or located together, such as having a police department and library share parking lots.
 - Actively research state and federal grant and other funding opportunities in advance and link this with the City's CIP plan.
 - Assess bond funding issues and strategies.
 - Identify innovative funding strategies.
- By optimizing and leveraging funding sources, the City can increase the potential of available funds for projects, increase the number of projects that can be implemented, and reduce the impact of the debt that the City would otherwise incur.
- *Develop Citywide CIP Plan.*
 - Develop transparent schedule of projects over five to ten years and a financing strategy.
 - Incorporate deferred maintenance and unfunded needs.
 - Link CIP plan to Enterprise Asset Management, department plans, and the General Plan and community financing plans.
 - Obtain input and approval from stakeholders, such as City Council and community planning groups.
 - Incorporate first year of plan into annual CIP budget.
- By conducting better planning, the City can show that capital decisions are fully supportable and improve transparency over projects and public perceptions. In addition, the City can reduce the risk of infrastructure failure and associated costs as well as the risk to public health and safety.

Conclusion

The City faces significant challenges in improving and maintaining its physical infrastructure in the current economy, and meeting basic renewal needs will require more creativity and strategic thinking. Establishing a capital program office will provide a leader who is accountable for effective management of the CIP and staff with the needed skills and perspectives to better plan for ongoing and future needs as well as how to address deferred maintenance. A small team can be created from existing resources or with a relatively small start-up cost and annual budget compared with the potential savings. As evidenced by San Francisco and Austin, numerous opportunities exist for improving the CIP.

Capital improvements are an investment in the future of the City. Making wise decisions for capital investments is critical not only given their high price tag, but also because decisions made now will impact the City for years to come. Committing resources for replacement, rehabilitation, or for new infrastructure without an effective process for guiding those resources raises the risk that the City is not making sound decisions or investing taxpayer resources wisely. It is particularly important to contend with these issues as the City plans to issue additional bonds to address the City's \$840 million backlog of deferred maintenance and capital needs.

Contract Bid and Award Process

During our audit, we identified several issues with the contract bid and award process that was, at that time, the responsibility of the Purchasing & Contracting Department. For example, we found inconsistent and unreliable contract data and potential understaffing of Contract Specialists. As a result, we included a performance audit of the City's contracting process in our Audit Work Plan for Fiscal Year 2012.

In July 2011, the Administration moved the contracting function for capital projects from Purchasing & Contracting to the Public Works Department.⁵ Public Works is currently conducting an internal business process reengineering assessment of the contracting function and is planning to make significant changes in the next six months. In addition, we are currently conducting an audit survey to identify problems with the previous contracting system and plan to provide this information to Public Works to ensure these problems are addressed by the new process.

⁵ Within the Public Works Department, the Construction Contracting Division handles all types of construction and General Requirements contracts, and the Architectural and Engineering Division handles consultant contracts.

Please contact me if you need any further information.

Respectfully Submitted,

A handwritten signature in cursive script that reads "Eduardo Luna". The signature is written in a dark ink and is positioned above a horizontal line.

Eduardo Luna
City Auditor

cc: Honorable Mayor Jerry Sanders
Honorable City Council Members
Jay M. Goldstone, Chief Operating Officer
Wally Hill, Assistant Chief Operating Officer
Mary Lewis, Chief Financial Officer
Jan Goldsmith, City Attorney
Andrea Tevlin, Independent Budget Analyst